

A Suasana Indah Sdn Bhd (In members' voluntary liquidation) v Ketua Pengarah Hasil Dalam Negeri

HIGH COURT (KUALA LUMPUR) — CASE STATED NO R2-14-5-98
AZMEL J

31 DECEMBER 1998

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Revenue Law — Income tax — Assessment — Compensation for alleged termination of agreement — Whether withdrawal of capital — Whether payment was actually for services rendered — Whether payment should be treated as loss of income

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The appellant entered into a joint venture agreement ('the agreement') with Syarikat Perniagaan Selangor Sdn Bhd ('SPSSB') in respect of a project for the development of two pieces of land ('the land') owned by SPSSB. Under the agreement, the appellant was to obtain approval from the relevant authorities in respect of the land. Both the appellant and SPSSB were to contribute paid-up capital towards the agreement. However, both parties did not do so. The agreement was later terminated due to disagreement between the appellant and SPSSB. A sum of RM6.4m ('the sum') was paid to the appellant by SPSSB as compensation for the termination of the agreement. The appellant contended that the sum was not assessable to income tax, being: (i) a withdrawal of capital; and (ii) compensation for loss of rights under the agreement. On the other hand, the respondent contended that payment of the sum amounted to: (i) payment of services rendered; or (ii) compensation for loss of income as a result of termination of the agreement. The Special Commissioners of Income Tax arrived at a decision in favour of the respondent. The appellant appealed.

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Held, dismissing the appeal:

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(1) 'Withdrawal' presupposes the existence of the element of 'injecting in'. Hence, for the sum to amount to a withdrawal of capital, the appellant must show that the sum had earlier been injected into the agreement. As the appellant had failed to show any evidence of such capital injection, the sum thus did not amount to a withdrawal of capital (see pp 69F-70E).

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(2) Mere surrendering of rights did not make the payment of the sum a capital receipt without there being a destruction of the structure of the profit-making status of the appellant. For the sum to amount to a compensation for loss of rights under the agreement, the vital test was whether the agreement was related to the whole structure of the appellant's profit-making apparatus. There was no evidence adduced that after the termination of the agreement, the appellant was completely unable to carry out its other business objectives (see p 71A-D).

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(3) In determining whether money received by a taxpayer is an income or capital nature, one looks to the nature of the taxpayer's

business and activities, the character of the assets realized and the relationship between the two. If, having regard to these matters, the conclusion is reached that the particular realization was a normal incident in carrying on of the profit earning of the taxpayer's business, the receipt will be of revenue nature. On the facts, the appellant had performed his obligation that led to the enhancement in the value of the land, but at the time of the payment of the sum, no development had been made on the land, nor was there any sale. Thus, payment of the sum by SPSSB to the appellant must be for services rendered by the appellant to SPSSB, having regard to the fact that the appellant was in the business of management services (see p 73B-D); *Merv Brown Pty Ltd v FC of T* (1985) 85 ATC 4080 followed.

- (4) Payment of the sum could alternatively amount to a compensation to the appellant for loss of income as a result of the termination of the agreement under s 22(2)(b) of the Income Tax Act 1967 having regard to the enhancement in the value of the land through the services rendered by the appellant. Thus, payment of the sum should go into the ordinary trading receipt of the appellant (see pp 73F-74H); *Short Bros Ltd v Commissioner of Inland Revenue* 12 TC 955 followed.

[Bahasa Malaysia summary]

Perayu telah memasuki suatu perjanjian usahasama ('perjanjian tersebut') dengan Syarikat Perniagaan Selangor Sdn Bhd ('SPSSB') berkenaan dengan suatu projek untuk memajukan dua bidang tanah ('tanah tersebut') yang dimiliki oleh SPSSB. Di bawah perjanjian tersebut, perayu akan mendapatkan kelulusan daripada pihak-pihak berkuasa berkenaan tanah tersebut. Kedua-dua perayu dan SPSSB akan menyumbang modal berbayar selaras dengan perjanjian tersebut. Tetapi, kedua-dua pihak telah tidak berbuat demikian. Kemudian, perjanjian tersebut ditamatkan kerana tiada persetujuan antara perayu dan SPSSB. Sejumlah RM6.4 juta ('jumlah tersebut') telah dibayar kepada perayu oleh SPSSB sebagai pampasan untuk penamatan perjanjian tersebut. Perayu menegaskan bahawa jumlah tersebut adalah terjumlah kepada: (i) penarikan balik modal; dan (ii) pampasan untuk kehilangan hak di bawah perjanjian tersebut. Sebaliknya, responden menegaskan bahawa pembayaran jumlah tersebut terjumlah kepada: (i) pembayaran perkhidmatan yang diberikan; atau (ii) pampasan untuk kehilangan pendapatan sebagai akibat penamatan perjanjian tersebut. Pesuruhjaya Khas Cukai Pendapatan telah mencapai keputusan yang memihak kepada responden. Perayu telah merayu.

Diputuskan, menolak rayuan tersebut:

- (1) 'Penarikan balik' menganggapkan kewujudan elemen 'menyuntik ke dalam'. Oleh itu, bagi jumlah tersebut untuk terjumlah kepada

- A** penarikan balik modal, perayu tersebut mesti menunjukkan bahawa jumlah tersebut telah pun disuntik ke dalam perjanjian tersebut. Oleh kerana perayu gagal untuk menunjukkan sebarang keterangan mengenai suntikan modal, jumlah tersebut tidak terjumlah kepada penarikan balik modal (lihat ms 69F–70E).
- B** (2) Menyerahkan hak-hak begitu sahaja tidak menjadikan pembayaran jumlah tersebut suatu modal penerimaan tanpa memusnahkan struktur mengaut keuntungan perayu. Untuk jumlah tersebut sebagai terjumlah kepada suatu pampasan untuk kehilangan hak-hak di bawah perjanjian tersebut, ujian yang perlu adalah sama ada perjanjian tersebut adalah berkaitan dengan seluruh struktur jentera untuk mencari keuntungan perayu. Tiada keterangan yang dikemukakan bahawa selepas penamatan perjanjian tersebut, perayu tidak dapat menjalankan objektif perniagaannya yang lain sama sekali (lihat ms 71A–D).
- C**
- D** (3) Dalam menentukan sama ada wang yang diterima oleh pembayar cukai adalah berbentuk pendapatan atau modal, seseorang akan melihat kepada bentuk perniagaan dan aktiviti-aktiviti pembayar cukai, ciri-ciri aset yang direalisasikan dan juga hubungan antara kedua-dua pihak. Jika selepas mempertimbangkan perkara-perkara tersebut, kesimpulan dicapai bahawa sesuatu penjualan adalah suatu kejadian yang normal dalam menjalankan keuntungan perniagaan pembayar cukai, penerimaan tersebut akan berbentuk pendapatan. Di dalam fakta-fakta, perayu telah melaksanakan obligasi yang membawa kepada peningkatan nilai tanah tersebut, tetapi pada masa pembayaran jumlah tersebut, tiada kemajuan telah dibuat ke atas tanah tersebut, atau terdapat apa-apa penjualan. Oleh itu, pembayaran jumlah tersebut oleh SPSSB kepada perayu mestilah untuk perkhidmatan yang diberikan oleh perayu kepada SPSSB, dengan mengambil kira fakta bahawa perayu adalah di dalam perniagaan perkhidmatan pengurusan (lihat ms 73B–D); *Merv Brown Pty Ltd v FC of T* (1985) 85 ATC 4080 diikuti.
- E**
- F**
- G** (4) Pembayaran jumlah tersebut boleh secara alternatif terjumlah kepada pampasan kepada perayu untuk kehilangan pendapatan sebagai akibat penamatan perjanjian tersebut di bawah s 22(2)(b) Akta Cukai Pendapatan 1967 dengan mengambil kira peningkatan nilai tanah tersebut melalui perkhidmatan yang diberikan oleh perayu. Oleh itu, pembayaran jumlah tersebut sepatutnya memasuki penerimaan perdagangan biasa oleh perayu (lihat ms 73F–74H); *Short Bros Ltd v Commissioner of Inland Revenue* 12 TC 955 diikuti.]
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Notes

- I** For cases on assessment of income tax, see 10 *Mallal's Digest* (4th Ed, 1996 Reissue) paras 1730–1739.

Cases referred to

Commissioners of Inland Revenue v Fleming & Co (Machinery) Ltd
33 TC 63 (refd) A

John Mills Production Ltd v Mathias (HM Inspector of Taxes) 44 TC 441
(refd)

London & Thames Haven Oil Wharves Ltd v Attwooll 43 TC 491 (refd) B

Merv Brown Pty Ltd v FC of T (1985) 85 ATC 4080 (folld)

Short Bros Ltd v Commissioner of Inland Revenue 12 TC 955 (folld)

Legislation referred to

Income Tax Act 1967 s 22(2)(b) C

A Subramaniam (Shook Lin & Bok) for the appellant.

Abu Tariq Jamaluddin (Legal Officer, Inland Revenue Department) for the respondent.

Azmel J: The appellant in this case had appealed by way of a case stated against the decision of the Pesuruhjaya Khas Cukai Pendapatan held on 10 April 1998 that the payment amounting to RM6.4m which the appellant received during the basic period for the year of assessment 1994 was income which is liable to be taxed under the Income Tax Act 1967. D

The brief facts of the case are as follows. The appellant company was incorporated on 7 February 1981. It entered into a joint venture agreement with Sykt Perniagaan Selangor Sdn Bhd ('SPSSB') on 4 September 1990. The joint venture was in respect of a project for the development of two pieces of land in Gombak owned by SPSSB. Under the joint venture agreement, the appellant had 48% equity and the balance was held by SPSSB. E

The main function of the appellant under the joint venture agreement was to obtain approval from the appropriate authorities for the following: F

- (i) conversion of land usage in respect of the two pieces of land;
- (ii) extension of the lease to 99 years; and
- (iii) sub-division of the said two pieces of land into parcels as provided in the lay-out plan. G

It was provided that the services rendered by the appellant as mentioned above was valued at RM4.8m.

SPSSB was to contribute RM520,000 and the appellant was to contribute RM480,000 as paid-up capital towards the joint venture project. However, both parties did not contribute towards the paid-up capital. H

By a letter dated 28 December 1992, the joint venture agreement was cancelled. It was terminated because of disagreement arising between the two parties. A sum of RM2.1m was paid to the appellant by SPSSB as reimbursement of expenses incurred by the appellant. SPSSB also paid another sum amounting to RM6.4m as compensation to terminate the joint venture agreement. I

- A** It is this amount of RM6.4m which the appellant had received from SPSSB that became an issue at the hearing before the Pesuruhjaya Khas Cukai Pendapatan and also at the hearing of the appeal before this court.

The appellant contended that the sum of RM6.4m received from SPSSB after the cancellation of the joint venture agreement is not income assessable to income tax being:

- B**
- (a) withdrawal of capital; or
 - (b) compensation for loss of all rights under the joint venture agreement.

On the other hand, the respondent contended that the said sum of RM6.4m is inassessable to tax being:

- C**
- (a) payment for services rendered; or
 - (b) compensation for loss of income as a result of termination of the joint venture agreement.

- D** The Pesuruhjaya Khas Cukai Pendapatan arrived at the decision in favour of the respondent's contention. Hence this appeal by the appellant to this court.

I shall now consider each of the contention of the parties beginning with the appellant's contention.

- E** *Whether it is a withdrawal of capital*

When we talk of 'withdrawal', it presupposes the existence of the element of 'injecting in'. Hence to withdraw a sum of RM6.4m it must be shown that that amount had earlier been injected into the joint venture as capital.

- F** And such figures must be shown in the records of the joint venture either in the form of resolutions of the board of directors or contained in the annual returns. In this case, it is incumbent upon the appellant to prove that such figures exist in the records of the joint venture. In other words, the board of directors of the joint venture must resolve that they had received capital of so much from each of the joint venture partners and recognized as such as paid-up capital. Mere provisions in the joint venture agreement that the joint venture partners shall contribute paid-up capital without more is not sufficient to conclude that paid-up capital had been injected by the partners in the joint venture. The joint venture agreement only indicates the obligation of each of the partners. There must be a resolution and execution of it to be followed.

- H** In fact, having regard to the nature of the joint venture, I have great doubt that there existed a partnership in the true sense of the word. Article 11.7 of the joint venture states:

Relation of Parties

- I** Nothing herein contained shall constitute the parties hereto as partners and it is expressly agreed that the relationship constituted by this agreement is that of a joint venture and not of a partnership or of a principal agency relationship.

This is a disclaimer voluntarily made by the parties to the JV agreement, including the appellant. As such, the appellant cannot now deny that the clause is a true statement, unless made under threat, promise or inducement. No such evidence had been adduced. Denial of the truth of such statement can only be made by persons not parties to the making of it. The logic of it is very simple. Statements made are deemed to be true. However, the makers of statements may make false statements because they want to hide to obtain certain pecuniary interests from it. So a third party is therefore allowed in law to challenge the truth of the statement made by the maker. The only situation where the maker is allowed to deny the truth of his statement is when the making of it is involuntary.

Therefore, the appellant in this case is not entitled in law to deny the truth of art 11.7 of the joint venture agreement unless it can be proved there existed elements of involuntariness when the appellant signed the agreement. No such evidence existed. I am even more convinced arriving at this conclusion in light of the fact that no evidence of any capital injection by the appellant had been recorded in any of the documents of the joint venture. Even assuming that the services rendered by the applicant were valued at RM4.8m and that amount presumably had been injected by the appellant into the joint venture, the fact still remained that the amount 'withdrawn' was RM6.4m which SPSSB in its letter regarded as 'compensation'. In my view, such claim by the appellant is mala fide and very unconvincing. This is not a case of making the difference in amount to be taxable. It is a case whether such contention is truthful or otherwise.

Having considered this issue thoroughly, I arrived at the conclusion that the Pesuruhjaya Khas Cukai Pendapatan was correct in holding that the sum of RM6.4m was not a withdrawal of capital.

Whether it is compensation for the loss of all rights under the joint venture agreement

This is an alternative contention put forward by the appellant. On this issue, it is pertinent to begin by examining the history of the incorporation of the appellant. The company was incorporated in February 1981. Its business objective was mainly to provide management services. Then in 1987 the appellant extended its objective to include real estates business and obtained a licence to do so. It only entered into this joint venture agreement in September 1990. On 28 December 1992, the joint venture agreement was terminated. It must be noted that in entering the joint venture agreement, the appellant was not prohibited or restricted from doing other business on its own. It was free to conduct its own business or to carry whatever business activities it had carried out prior to entering the joint venture agreement. It was admitted that the main purpose of bringing the appellant into the joint venture was to obtain the various approvals from the relevant authorities in respect of the said land. In so far as the obligations of the appellant were concerned, the work had been carried out.

In this respect, I would agree entirely with the contention of counsel for the respondent that the mere surrendering of rights does not make the

A payment of the RM6.4m a capital receipt without there being a destruction of the structure of the profit-making apparatus of the appellant. The principle applied by Ungood-Thomas J in the case of *John Mills Production Ltd v Mathias (HM Inspector of Taxes)* 44 TC 441 said at p 449 is on point. His Lordship said:

B The vital test is whether the agreement is 'related to the whole structure of the appellants' profit making apparatus'.

There was no evidence adduced that after the termination of the joint venture agreement the appellant was completely unable to carry out its other business objectives. Its liquidation was voluntarily carried out by reason of frustration. I must admit that it is quite difficult to imagine why

C the appellant was frustrated when they had received RM6.4m and had been reimbursed with another sum of RM2.1m. With such an amount of money they could enhance their business activities, particularly in real estate if they so wished. After all, the profit-making apparatus they had been using was their expertise in services management. I am sure termination of the joint

D venture agreement had not deranged their capabilities to give management services. On the other hand, the possibility of enhancing it through the experience obtained was quite likely. In the circumstances, I would not disturb the decision of the Pesuruhjaya Khas Cukai Pendapatan on this issue.

E *Whether the RM6.4m received by the appellant is payment for services rendered*

As a preliminary comment, once it has been proved that the above two contentions of the appellant cannot be sustained, there should not be anything else to prove. The onus is always on the appellant to prove its contention. If it has failed, then there is nothing for the respondent to prove.

F Nevertheless, since the Pesuruhjaya Khas Cukai Pendapatan had also given its decision in respect of the two contentions made by the respondent I shall proceed to consider them.

In considering this third issue, I think it is pertinent for me to refer to the letter of SPSSB dated 28 December 1992 which made the offer of

G payment of RM6.4m to the appellant. The relevant provisions in paras 2 and 3 of the letter read:

2 It would appear from the issues raised and the matters discussed that we have irreconcilable differences with regard to the continuing management and future direction of the JV project. In the circumstances and before matters deteriorate further, it would appear that the best

H solution for both of us would be for there to be an amicable parting of ways.

3 *We write to advise that we are prepared, after due deliberation on the matter, to pay you the total sum of Ringgit Six Million Four Hundred Thousand (RM6,400,000) as compensation to terminate the JV agreement between us and releasing you from the JV project and the JV agreement with immediate effect. Thereafter, neither party shall have any rights, title or*

I interest in the JV project and under the JV agreement or any claims

whatsoever against the other in respect of or arising under the JV project and the JV agreement and we shall be entitled to proceed with the development of the project entirely on our own. (Emphasis added.)

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This was a letter of offer by the respondent and was accepted in toto by the appellant. Acceptance of it is evidenced by the receipt of the sum of RM6.4m by the appellant.

B

In addition, there was the directors' report and audited accounts of SPSSB as at 31 December 1992, a relevant portion of which stated as follows (p 254 of the respondent's bundle of documents):

Since the end of the previous financial year, other than the director stated below, no director has received or is entitled to receive any benefits by reason of a contract made by the company or a related corporation with any director or with a firm of which the director is a member or with a company in which the director has substantial financial interest —

C

Name of director

Dato' Wong Kow
@ Wong Fook Shang

D

Nature of contract

Termination of joint venture agreement with Suasana Indah Sdn Bhd amounting to RM6.4m as services performed under joint venture agreement and RM2.1m as reimbursement of costs incurred for conversion, sub-division and extension of lease period of leasehold land of which Dato' Wong Kow @ Wong Fook Shang is a director and a shareholder with a substantial financial interest. (Emphasis added.)

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Dato' Wong Kow was a shareholder of the appellant company and had full knowledge of the report and had not raised any objection to the contents of the report.

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And at p 262 of the same bundle of documents of the respondent, it is stated:

Included in the development properties is a sum of RM6.4m paid by the company to Suasana Indah Sdn Bhd in respect of services performed by Suasana Indah Sdn Bhd for development of the leasehold land to the termination of the joint venture agreement and RM2.1m as reimbursement of costs incurred for conversion, sub-division and extension of lease period of leasehold land. (Emphasis added.)

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The contents of the said report as stated above spoke clearly of the purpose of payment of the RM6.4m to the appellant and tallied with what was said in the letter of offer by the respondent dated 28 December 1992.

H

It is common ground that as a result of the approvals obtained by the appellant in respect of the said leasehold land, its value had been enhanced from RM5.3m to about RM15m. It must also be noted that at no time was the said leasehold land transferred to the JV. It remained all the time in the ownership of SPSSB, which directly benefited resulting from the conversion of the leasehold land. Therefore, the payment of RM6.4m by SPSSB to the appellant was appropriate for the services rendered to enhance the value of

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- A the land. After all, the appellant was a specialist in the business of performing such management services. With such facts as stated above, as well as the appellant's disclaimer to be in partnership with SPSSB as stated in the JV agreement, it is quite natural to arrive at the conclusion that the appellant was in fact only rendering management services to SPSSB under the JV agreement. In this regard, the observation made by the Federal Court of Australia in the case of *Merv Brown Pty Ltd v FC of T* (1985) 85 ATC 4080 is in point. It states:
- B

In determining whether moneys received by a taxpayer are for an income or capital nature one looks to the nature of the taxpayer's business and activities, the character of the assets realized and the relationship between the two. It is necessary to make both a wide survey and an exact scrutiny of the taxpayer's activities. If, having regard to these matters, the conclusion is reached that the particular realization was a normal incident in the carrying on of the profit-earning operations of the taxpayer's business, the receipt will be of revenue nature.

- C
- D Applying the above principle to this case, the appellant had in fact performed his obligation that led to the enhancement in the value of the leasehold land. But at the stage when the payment of RM6.4m was made, the converted properties had not been properly developed and no sale had taken place and as such, no profits had been derived by SPSSB yet. Therefore, the payment must be for the services already rendered by the appellant to SPSSB, having regard to the fact that the appellant was in the business of management services. In the circumstances, I would also agree with the conclusion of the Pesuruhjaya Khas Cukai Pendapatan on this issue.
- E

Whether the RM6.4m received by the appellant is compensation for loss of income as a result of the termination of the contract

- F
- This issue represents the alternative contention of the respondent in respect of the payment of the RM6.4m. The respondent contended that the payment was in fact compensation for loss of income under s 22(2)(b) of the Income Tax Act 1967. In support of his contention, the respondent relied on the decision of Diplock LJ in the case of *London & Thames Haven Oil Wharves Ltd v Attwooll* 43 TC 491 where he said:
- G

Where, pursuant to a legal right, a trader receives from another compensation for the trader's failure to receive a sum of money which, if it had been received, would have been credited to the amount of profit (if any) arising in any year from the trade carried on by him at the time when the compensation is so received; the compensation is to be treated for income tax purposes in the same way as that sum of money would have been treated if it had been received instead of the compensation. The rule is applicable whatever the source of legal right of the trader to recover the compensation. It may arise from a primary obligation under a contract, such as a contract of insurance, from a secondary obligation arising out of non-performance of a contract, such as a right to damages either liquidated, as under the demurrage clause in a charterparty, for unliquidated, from an obligation to pay damages for tort ... from a statutory obligation; or in any other way in which legal obligations arise.

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On this issue, the Pesuruhjaya Khas Cukai Pendapatan arrived at the following finding:

The JVA was an agreement to jointly develop a specific project at Mukim Hulu Kelang, Daerah Gombak and how the trading profits, when earned, should be distributed as between the appellant and SPSSB. The termination of the JVA did not destroy the whole structure of the appellant's profit-making apparatus. The RM6.4m paid was in settlement of the appellant's claim of future loss of income. It was a payment in respect of future rights to profits and not a withdrawal of capital as claimed by the appellant.

In support of the finding, the Pesuruhjaya Khas Cukai Pendapatan quoted a part of the decision of Russell J in the case of *Commissioners of Inland Revenue v Fleming & Co (Machinery) Ltd* 33 TC 63:

... it appears that the compensation received is no more than a surrogatum for the future profits surrendered — the compensation received is in use to be treated as a revenue receipt and not a capital receipt.

The Pesuruhjaya Khas Cukai Pendapatan went on to state in their findings:

Further the termination of the JVA was a cancellation of a contract made in the ordinary course of the appellant's business.

To support that conclusion, they quoted the decision of Lawrence LJ in the case of *Short Bros Ltd v Commissioner of Inland Revenue* 12 TC 955 where his Lordship said:

The solution ... seems to me to depend entirely upon whether this sum ... was an annual receipt or was a capital receipt. It appears to me that, in a business of this kind, where a contract has been entered into in the ordinary course of business, a sum received for the cancellation of that contract is a sum which should go into the ordinary trading receipt of the company.

In my view, taking into consideration the nature of the business of the appellant before it entered the JV agreement and also the obligations entrusted upon the appellant to perform under the terms of the JV agreement, I agree completely that such agreement was made in the ordinary course of the appellant's business. There was no evidence that the appellant intended to inject any amount of capital, let alone a sum of RM6.4m in the JV. And when the agreement was terminated the payment of the RM6.4m was made as compensation for loss of income, having regard to the enhancement in the value of the land after having been successfully converted through the services rendered by the appellant. Therefore, on the basis of the principle stated in *Short Bros Ltd*, the sum of RM6.4m received due to the termination of the JV agreement was a sum which should go into the ordinary trading receipt of the appellant.

I therefore hold that the conclusion made by the Pesuruhjaya Khas Cukai Pendapatan on this final issue is also correct and should not be disturbed.

In the circumstances of this case, I dismissed the appeal with costs.

Appeal dismissed.